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REPORTS OF THE RETIREMENT BENEFIT COMMITTEE ON THE LEVEL AND STRUCTURE OF CPP RETIREMENT BENEFITS

May 1989

FOREWORD

The Canada Pension Plan (CPP) Advisory Board is a statutory body whose members are private citizens appointed to represent employees, employers, self-employed persons and the public. Its role is to review the operation of the CPP, the state of the CPP Investment Fund and the adequacy of coverage and benefits payable under the Plan.

In keeping with its last function, the Advisory Board has submitted to me a majority and two minority reports on the Level and Structure of the CPp Retirement Benefits.

These reports examine the adequacy of the current CPP retirement benefit system and investigate the need and the costs of various possible increases in benefits. The Committee is of the opinion that although the majority of Canadian workers are adequately covered by existing retirement provisions, a significant minority of middle income Canadians are not. The Committee agreed that a valid case could be made on these grounds for increasing CPP benefits, but the case was judged not to be a compelling one. The Committee recommends a review of the basic question in five years. A divergence from these views is expressed in two minority reports.

I am pleased to make these reports public and hope that it will stimulate discussion in the future.

Perrin Beatty

Minister of National Health
and Welfare

Canada Pension Plan advisory board
Régime de pensions du Canada conseil consultatif

The Honourable Perrin Beatty, P.C., M.P.
Minister of National Health and Welfare
House of Commons
Ottawa, Ontario
K1A 0A6

Dear Mr. Beatty:

At its fortieth meeting on May 18 and 19, 1989, the Canada Pension Plan Advisory Board gave its approval to the Report of the Retirement Benefit Committee on the Level and Structure of CPP Retirement Benefits. I now submit this report on behalf of the Advisory Board, along with two minority reports expressing concerns with the majority report, for your consideration.

Yours sincerely,

Louis Erlichman

Louis Erlichman
Chairman

attachment

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CONTENTS

I INTRODUCTION

The mandate of our Committee was:

"To assess the adequacy of current CPP retirement benefits, and to recommend any changes to the level or structure of benefits."

In pursuit of this, research has included:

(a) a survey of plans for other countries;
(b) an investigation of costs of various possible increases in benefit; and
(c) a study of the coverage percentages and replacement rates of existing public and private programs.

"Adequacy" is a subjective judgment made by interpreting data presented and filtering it through one's own value system.

The Committee has had difficulty reaching a consensus as to whether an increase in benefit levels is necessary. To some extent, this reflects differences in value systems of the members, but differences in interpretation of the data appear to have played at least as large a role.

Our conclusion is that no change in the level or structure of CPP retirement benefits is desirable at this time.

Meetings:

February 12, 1988 - Ottawa, Ontario
April 25, 1988 - Ottawa, Ontario
August 25, 1988 - Ottawa, Ontario
February 1, 1989 - Ottawa, Ontario

Committee Members:

Mr. W.A. Black (Chairman)
Mr. Marcel Le Houillier
Mr. Harvey Atkinson
Mr. William Crawford
Mrs. Geraldine Gilliss
Mrs. Joan Prevalnig
Mr. Frank Romano

II SURVEY OF OTHER COUNTRIES' PLANS

The table below shows costs and maximum benefits available from the plans in France, Japan, the United Kingdom, and the United States.

Generally speaking, replacement levels in Canada are in the same range as the other countries, with the exception of Japan, which replaces about three-quarters of pensionable earnings.

In every case, however, the amount of eligible earnings is greater than Canada, ranging from one and a half times in Japan to two and a half times in the United States.

The payroll costs of providing these benefits is much greater in all of those jurisdictions, although it should be noted that the OAS portion of Canada's benefits is funded out of general tax revenues.

As a general conclusion, Canada's social security retirement benefits are smaller than those of the four jurisdictions studied. Appendix A contains a more complete summary of the data gathered on foreign jurisdictions.

	Contribution Levels as a % of Pensionable Earnings	Maximum Benefit Achievable
Canada (1988)	CPP costs 4.0% in 1988, increasing to 7.6% in 2011; OAS funded from General Revenues*	Approximately 40% of Earnings Up to 100% of Average Industrial Wage
France (1986)	14.6%	50% of earnings up to 150% of the AIW
Japan (1987)	11.6% (Female) 12.4% (Male)	75% of earnings up to 150% of the AIW
United Kingdom (1987)	10% - 19.45% (depending on employment status)	40% of earnings up to 200% of the AIW
U.S.A. (1988)	15.00% in 1988, growing to 15.3% in 2000	41% of earnings up to 250% of the AIW

*Expenditures on the basic OAS pension represent about 5% of total CPP pensionable earnings (1985). Total OAS/GIS/SPA program costs represent about 7% of total CPP pensionable earnings (1985).

III COSTS

In Appendix B can be seen the cost of running additional benefits through the CPP under various phase-in scenarios.

The Appendix describes costs for an additional CPP benefit equal to a further 25% of earnings ("CPP II"), phased in over 10, 20 and 40 years.

Obviously, benefit increases of other sizes have costs proportionate to those shown.

A few conclusions:

(a) In every case, unless an adequate funding level is stipulated initially, the funding costs ultimately reach the "pay go" rate of just over 10%.

(b) Based on an initial funding rate of 3.6% and a 20-year phase-in, no funding increases would be needed until at least the year 2010.

(c) The funding level which could be considered as "adequate", that is, no anticipated future increases, is 5.86%, based on a 20-year phase-in.

At this benefit level (i.e., 25% current plus 25% new), the ultimate costs of combined CPP retirement benefits would be:

(a) About 17% of payroll if "CPP II" is adequately funded from inception.

(b) About 22% of payroll if "CPP II" has funding which eventually becomes pay-go.

Of course a smaller "CPP II" benefit would have a proportionately smaller cost. For example, a 15% benefit phased in over 20 years would immediately cost an additional 3.5% of payroll, shared equally between employer and employee.

APPROXIMATE COST OF BENEFITS*

	Present CPP Plan of 25%	With Additional 15% Benefit** for a Total of 40%		With Additional 25% Benefit** for a Total of 50%	
		Partly*** Funded	Fully*** Funded	Partly*** Funded	Fully*** Funded
Cost Now	5.5%	7.5%	9%	9%	11.5%
Ultimate Cost	11.5%	17.5%	14%	22%	17.5%

* All costs are expressed as a percentage of existing contributory earnings, i.e., earnings between the YBE and the YMPE. This is greater than the current contribution rate.

** Phased in over 20 years.

*** "Fully Funded" means funding is initially set at a level which will never have to be increased. "Partly Funded" means more than "pay-go", but less than fully funded.

IV ADVANTAGES OF CPP OVER PRIVATE PLANS

Access to pension coverage is not provided on an equal basis in Canadian society. Individuals employed in the public sector and large private corporations have good access. Individuals in small private enterprises have little or no access.

It is advantageous to society to have as many retirees as possible receive pensions earned through their own efforts and contribution to society. Pensions based on service and earnings are in general preferable to welfare. (However, GIS would have to be in place for persons with very low earnings, short careers and so forth.)

Given that persons with limited incomes will not voluntarily save for retirement, and small private employers will not voluntarily add to their personnel costs, coverage for this group can only be improved if it is made mandatory.

The irony, then, is that equal access implies mandatory participation. Quite probably this is not a big issue with employees, at least. Employees in similar financial circumstances, but under employers who offer pension plans, seem to accept mandatory participation fairly well, on the whole.

Providing retirement benefits through the CPP has certain advantages over doing so through private programs:

(a) CPP provides full protection against cost of living increases. Most private plans do not.

(b) CPP is comprehensive - it covers virtually all employed workers. Participation in private programs (both pensions and RRSP's) appears to be about 75%, and is unlikely to increase significantly in the foreseeable future.

(c) It would appear that the CPP system delivers benefits efficiently and cost-effectively. The cost of administration is less than 2.0% of benefits, less than most private plans.

(d) The CPP system provides for portability when changing employers. Incomplete and inconsistent implementation of pension reform, and the limitations of what is being implemented, makes portability between private plans highly imperfect.

(e) The CPP Advisory Board has recommended credit splitting as a way of providing benefits to homemakers. In the absence of a similar provision within private plans, the resulting benefits to homemakers are insufficient.

V FISCAL IMPACT

The present CPP fund is approximately $35 billion, and is growing at something less than the rate of interest, since benefits exceed current contributions. Contribution levels are set to develop the fund to a level approximately equal to two years' benefits.

Increasing the benefit would, assuming the increase is accompanied by a contribution rate increase, substantially add to the amount of money in the CPP Fund. This is particularly so if the increase in benefit was more adequately funded.

This could lead to a greater savings rate in the Canadian economy, putting downward pressure on interest rates. On the other hand, the substantial increase in readily available funds to Provincial Governments (if the funds were invested the same way as at present), may lead to an increase in provincial deficit spending. Of course, it is possible to have a different investment policy with respect to any additional CPP funds. For example, private sector investment managers could be retained, perhaps in proportion to the success they enjoy competing for private savings.

The existence of a larger Canada Pension Plan would reduce the number of present beneficiaries who are also eligible for GIS. GIS is funded from general revenues, and accordingly, this would reduce the costs to the average taxpayer. At present the GIS costs are $3.9 billion, as compared to annual CPP retirement benefits of $5.4 billion. Intuitively, one would expect CPP to be much larger in relation to GIS.

For those now eligible for GIS, any increase in the CPP retirement benefits will mean a fifty cents on the dollar decrease in GIS benefits; in fact, the low-income worker would end up paying the increased contributions for reduced extra benefits. The amount payable from RRSP or employer-sponsored pension plans will partially reduce the amount of GIS that would have been available to him without any contribution.

For this reason, there is concern that an increase in CPP benefits, and associated costs, would result in a decrease in the breadth and extent of private plans.

As well, there is a real concern about the affordability, at lower income levels, of further required CPP contributions.

Appendix C provides two interesting commentaries on this topic from the business press.

VI CRITERIA FOR PROGRAM EVALUATION

Considerable energy and expense have been invested over the past decade evaluating the effectiveness of both public and private programs. A survey of the available literature can lead one to a fairly broad range of conclusions, depending on the significance given to some items, and the priority given to others.

For example, some studies have included the benefit of home ownership in assessing the adequacy of pension benefits.

As one examines the various studies into coverage and replacement, a number of interpretive issues emerge:

1. Should we be studying the circumstances of individuals or family units? Historically, the one-earner family unit was the norm. Today, however,a number of households are single, and two-earner families are also best represented as singles. As well, if the recommendation in favour of annual credit splitting for homemakers is accepted, then every household becomes two-earner household for pension purposes. (The key difference is in GIS offsets.)

2. Which earners should we be looking at? There appears to be a broad consensus on this question. As shown in Exhibit 3, replacement rates for the low-income group are already quite high because of the flat-level benefit coming from OAS, and the income supplementation coming from GIS. At the other extreme, replacement rates for high earners are low, but it is generally considered that these earners are better able to take care of themselves, at least in respect of those earnings up to the average.

   Increasing CPP retirement benefits for low earners has, generally, reduced effect on their after retirement income -- higher CPP benefits cause a 50% reduction in GIS benefits.

   Increasing CPP retirement benefits would provide higher pensions to high earners and might not be viewed positively by the general public if low- and middle-earners are perceived as not benefitting by the changes.

   Accordingly, the question of adequacy focuses on the middle-earners' group.

3. Which comes first? More precisely, in what order should we consider various benefits to which we may be entitled? These include OAS, GIS, CPP, private pension, RRSP's, and other savings.

   The problem with private plans is the very incomplete participation. Exhibit 1 suggests that our middle-income group (those with earnings of 75% - 125% of the average) has only perhaps 75% participation. Accordingly, while perhaps three-quarters of CPP contributors are participants in RRSP or pension plans, there is clearly a significant minority who are not. There is no indication that this minority is about to decrease in size. Accordingly, for that group, we have to ignore the impact of private pension plans.

   By way of contrast, the GIS is universally available. A serious problem is that, at present CPP benefit levels, even those qualifying for the maximum benefit have some GIS eligibility. Because GIS is income-tested, it is more expensive than either CPP or OAS to administer, and arguably it is socially undesirable that middle-income earners should need an income-tested benefit to make their pensions meet a minimum test of adequacy. Accordingly, it is felt that the CPP benefit needs to be evaluated, assuming OAS, but no other benefits. That is to say, we should be looking at column (3) in Exhibit 2, not column (5).

4. What adjustments for taxation should be made in evaluating adequacy? Before retirement, a portion of one's income is directed toward CPP and UIC. After retirement, they are not. There are additional tax advantages to being retired. Thus it is felt comparisons of net after-tax income, post-retirement to pre-retirement, are more valuable than gross.

5. What impact should be given to homeownership? During the working years, many if not most, contributors are accumulating equity as they pay off their mortgage. Typically, after retirement the house is owned, and the contributor use it as a residence paying only expenses. Should the benefit of this be considered in adequacy determination?

6. Typically, a household immediately prior to retirement has a consumption level considerably less than its income. Should retirement benefits be tested on replacement of income or replacement of consumption?

VII COVERAGE AND INCOME REPLACEMENT

The exhibits chosen for inclusion here (which represent a very small portion of available data) represent three views of the replacement question. Exhibit 2 simply shows the net income replacement rates for single and family household units at various income levels, with and without GIS. Arguably, this is the minimum evaluation of replacement rates that can be given. For our 25% or so of middle income earners that do not have pension plans, the single individual replacement rate (without GIS) is 52%. Most would agree that this is not adequate.

Exhibit 3 shows us an effort to describe replacement rates of income from all Government programs, including GIS. Here our middle-income group is doing rather better, even without the benefit of private programs, which most of them would have.

Finally, Exhibit 4 shows a comprehensive evaluation of adequacy considering both public and private programs, the benefits of taxation, and the benefits of home-ownership where applicable. This shows:

- 85% of households achieve a 75% net income replacement level after retirement if you include CPP, OAS, GIS and other post-retirement income, including savings.

- This percentage of households has been forecasted to increase to 90% after pension reform.

- Full income replacement, even if affordable, may not inherently be an appropriate objective because comparison of post-retirement income with income just before retirement can be misleading. This may result in an unreasonably high standard of adequacy. For example, as emphasized in British Columbia's 1982 position paper, a household's real income is generally higher just before retirement than at any other point in time. However, major expenditures associated with child rearing are usually completed, durable goods such as automobiles and appliances are fully paid for. In addition, most households occupy a fully owned home free of mortgage payments. As a result, households near retirement are significant net savers. It is questionable whether income levels in retirement should be so high as to continue high levels of savings. Retirement is naturally a period of dissaving which implies replacement rates of less than 100%.

- If middle earners were "forced" to increase contributions to CPP to support a higher benefit level at retirement, the effect may be to cause a reduction in personal savings and asset accumulation. Should this occur, their income replacement levels after retirement may be unaffected by increasing the CPP retirement benefit.

- With CPP contributions by both employee and employer on the rise for the foreseeable future, unless a serious shortcoming in the level of benefits currently delivered by the CPP program was identified, popular support for an increase in the level of benefit might be minimal. If public support were minimal, political initiative to implement changes could be expected to be nonexistent.

Thus, it can be seen that how one feels about adequacy will depend very much on which data one chooses to examine. Those who felt that Exhibit 4 is representative see no pressing need for increase in public programs. This group would feel it is justified to take into account personal savings and the value of home-ownership because we would otherwise consider the government as the only part responsible to assure all Canadian workers the means to retire. The value of home-ownership is particularly important because a major portion of Canadians retire when their mortgage is already paid-up, reducing expenses after retirement.

On the one hand, if one takes Exhibit 2 as being representative, and in particular the 52% replacement rate for single individuals without GIS, then one would argue that a larger CPP benefit is required.

The advent of Pension Reform only serves to add uncertainty. The Federal Government Green Paper speculates that it will result in increased private plan participation.

On the other hand, if employers find the complications of the new regime intimidating, or if the tendency toward defined contribution plans makes more of them voluntary, then the participation level may actually decrease.

VIII CONCLUSION

We stated in the introduction that the Committee had great difficulty reaching consensus because of differences in value systems, and in developing shared views on data interpretation.

We have nevertheless been able to reach agreements on the following statements:

1. The available data did not indicate a need for elevating Canada Pension Plan benefits on behalf of low- or high-paid workers. If there is a need, it is in the area of middle-income workers.

2. It is preferable, both socially and fiscally, that retired Canadians, particularly those in the middle-income group, receive their benefits from the CPP rather than a Guaranteed Income Supplement. Thus, while looking at the appropriateness of CPP benefit levels, we should look at the total benefits available to individuals before considering a Guaranteed Income Supplement.

3. It is proper to look at net after-tax rather than gross income replacement rates in evaluating the adequacy of benefits.

4. Because of the rapid increase in two-earner households, the couple-with-one-breadwinner household is no longer a representative model on which conclusions can be based. Accordingly, we must examine income replacement rates of retired individuals, rather than households.

5. Participation in private pension or RRSP arrangements in the targetted middle-income group is about 75%. Thus, there is a significant minority of this group for whom government programs represent their only retirement income.

6. Because of the value of home-ownership, and the likelihood that spending just prior to retirement is rather less than total income, an "adequate" replacement rate is something less than 100%.

If there is a case to be made for increased CPP retirement benefits, it is on behalf of that significant minority of middle-income earners who do not participate in private plans. For these individuals, the net income replacement rate is about 50%.

To add 15% to that replacement rate, phased in over 20 years, could have an immediate level payroll cost of about 3½% to be shared between employer and employee. There is concern that this increase in benefit funding would be viewed as a burden by exactly those people whom it is designed to help. To the extent that it displaces GIS benefits, it would be shifting the burden from the general taxpayer to those individuals who would benefit.

A majority of Canadian workers are adequately covered by existing retirement programs. A significant minority of middle-income Canadians are not. A case can be made that total CPP benefits should be increased to improve the adequacy level of this group's replacement rate. The case is valid, but not compelling. It would result in a greater proportion of retirement income for these individuals coming from their own savings and that of their employers, rather than from the general taxpayer.

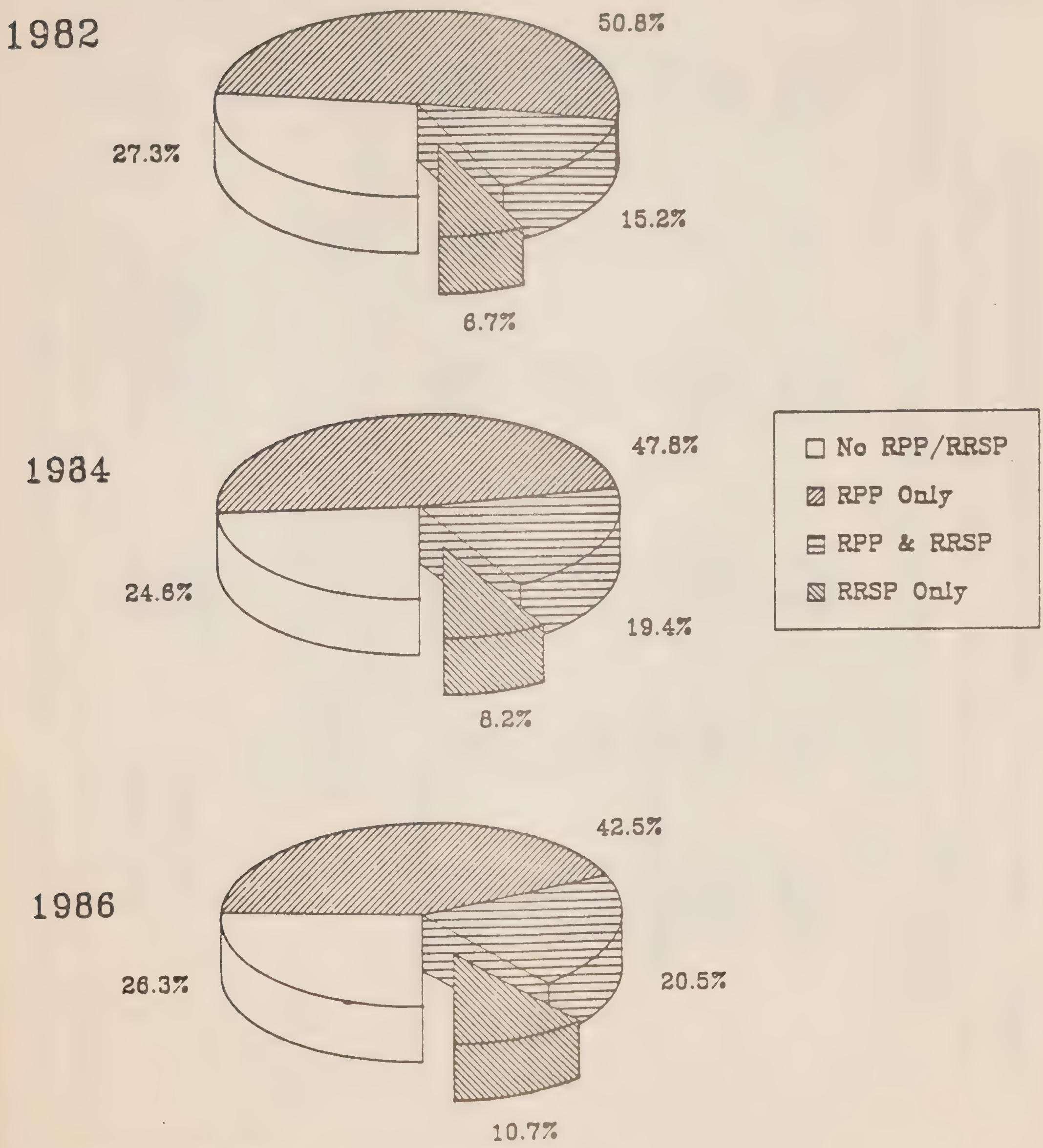
We therefore do not recommend a change in the level or structure of CPP retirement benefits at this time.

Adequacy of coverage of the middle-income group is a continuing concern. Opportunities to promote increased coverage through public policy initiatives affecting private pensions and RRSP's should be sought.

This basic question should be reviewed in five years with special emphasis on the middle-income group.

EXHIBIT 1

PENSION COVERAGE AMONG CPP CONTRIBUTOR MIDDLE-EARNING* EMPLOYEES AGED 25-64, 1982 - 1986



* Annual earnings at .75-1.25 times average wages, based on average weekly wages and salaries, Canada.

Exhibit 2 - Rate of employment income replacement guaranteed by public plans in 1984

(1) Gross Income Before Retirement		(2) Disposable Income* Before Retirement	(3) Disposable Income At Retirement, Derived from the OAS + QPP		(4) GIS Benefit	(5) Disposable Income at Retirement, GIS Derived from the OAS, QPP + GIS
in $	as a % of the AIW**	in $	in $	as a % of (2)	In $	as a % of (2)
Person Living Alone						
10,000	50	8,626	5,501	64	2,764	96
15,000	75	11,783	6,620	56	2,205	75
20,000	100	14,757	7,730	52	1,646	64
25,000	125	17,631	7,730	44	1,646	53
30,000	150	20,356	7,730	38	1,646	46
35,000	175	23,243	7,730	33	1,646	40
40,000	200	25,424	7,730	30	1,646	37
Couple with one Breadwinner						
10,000	50	9,849	8,868	90	3,938	130
15,000	75	13,300	10,085	76	3,380	101
20,000	100	16,405	11,209	68	2,820	86
25,000	125	19,424	11,209	58	2,820	72
30,000	150	22,277	11,209	50	2,820	63
35,000	175	24,965	11,209	45	2,820	56
40,000	200	27,555	11,209	41	2,820	51

* After deduction of income tax and compulsory social contributions

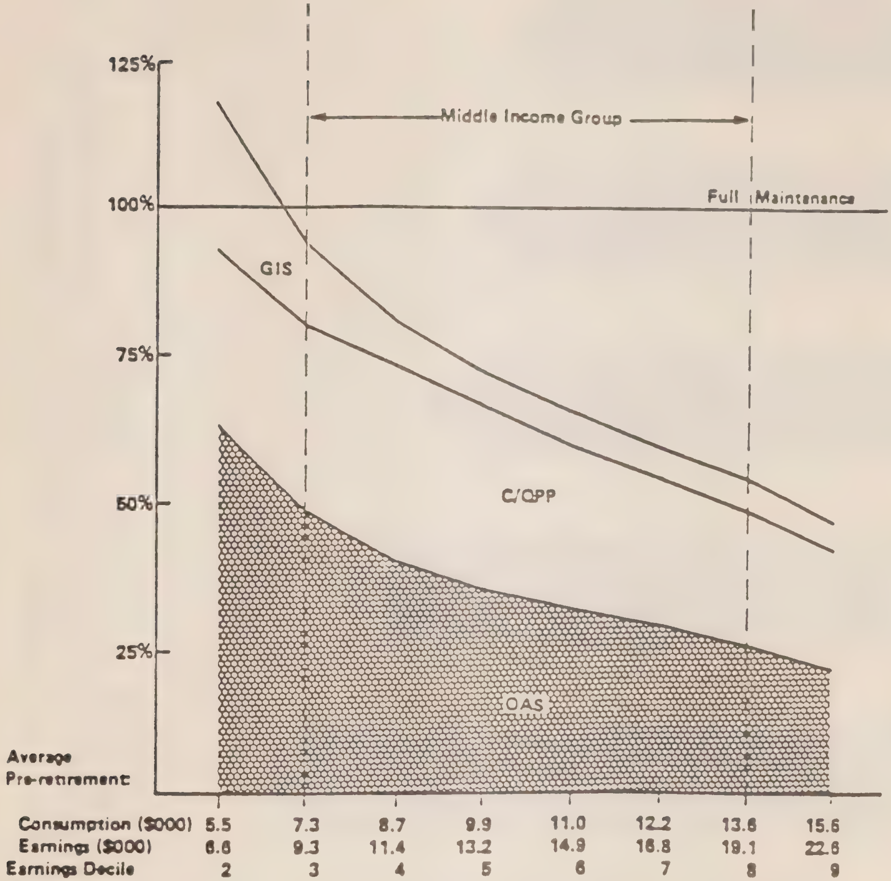
** Rounded-off percentage of the average industrial wage, which was $20,800 in 1984 according to a survey made by Statistics Canada

N.B. In households where both spouses work, each one is considered as a person living alone

SOURCE: The Quebec Policy on Retirement Income Security: Province of Quebec, 1985

EXHIBIT 3

Extent to Which Pre-retirement Living Standards are Maintained After Retirement by the Public Pension Programs(1)

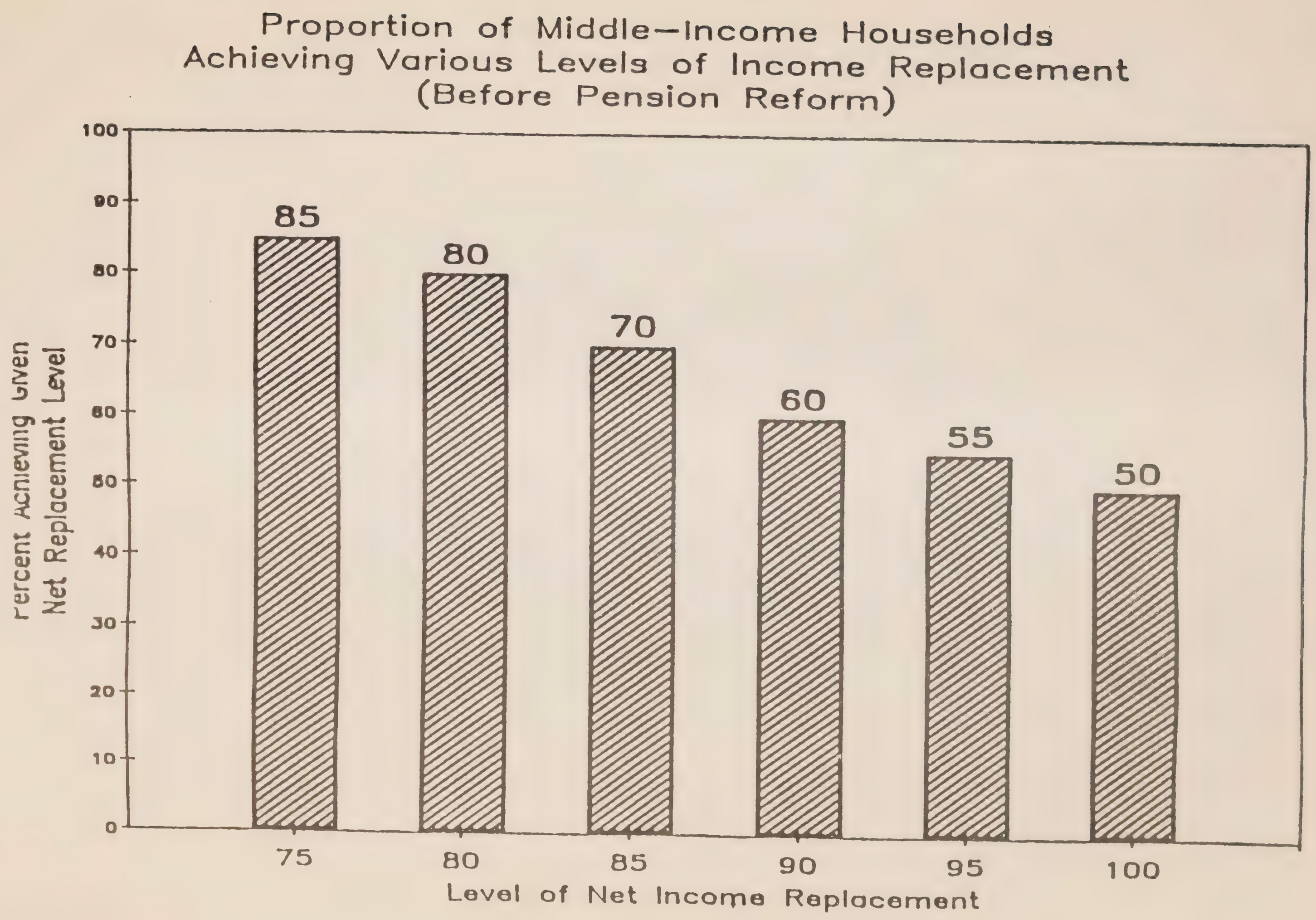


(1) The C/QPP replaces 25% of pre-retirement earnings up to the level of average wages and salaries. The employee pays one-half of full cost C/QPP rates. Taxes, transfers and UI premiums are based on their 1977 values, the same year in which the earner enters the labour force.

SOURCE: The Retirement Income System in Canada:

Problems and Alternative Policies for Reform Federal Government Task Force, 1979

EXHIBIT 4



Proportion of Middle-Income Households
Achieving Various Levels of Income Replacement
(Before Pension Reform)
Percent Achieving Given
Net Replacement Level
100
90
80
70
60
50
40
30
20
10
0
85
80
70
60
55
50
75
80
85
90
95
100
Level of Net Income Replacement

APPENDIX A

SURVEY OF OTHER COUNTRIES' PLANS

QUESTIONS	FRANCE	JAPAN	UNITED KINGDOM	UNITED STATES OF AMERICA
1. What is the benefit level and how is it accrued:				
a) flat;	None	NATIONAL OLD AGE PENSION (BASIC PENSION). The benefit is payable to those who reached age of 65, and completed a qualifying period of at least 25 years (the total of "contribution paid period" and "contribution exempted period"), covers all residents. In 1987, the maximum monthly benefit was ¥52,200($552 Cdn.). The benefit is automatically indexed on April 1st, using the Consumer Price Index.	Retirement benefits consist of 2 components. The flat-rate varies by family status, years of insurance and age at retirement. In 1987, the weekly benefits were: single £39,50 ($85.50 Cdn.); Married £78.15 ($169.16 Cdn.); persons age 80 or older receive a weekly supplement of £30.95 ($67.00 Cdn.). Retirement pensions are adjusted annually using the Consumer Price Index.	OLD-AGE, SURVIVORS, AND DISABILITY INSURANCE (OASDI). Monthly benefits are paid as a matter of earned right to workers who gain insured status and to their eligible spouses and children and survivors. Benefits are related to past earnings with two exceptions: - Fixed-rate "special age-72" monthly benefits payable to certain persons born before January 2, 1900, effective December 1987, $146.10 U.S. ($175.26 Cdn.). - "Special minimum" benefits, based on number of years with specified minimum amounts of covered earnings, for workers with low earnings but long attachment to the labor force.
b) related to pre-retirement income;	Under the general social security system of France, which is based on age, years of "insurance" and earnings. In 1987, the maximum old age pension is F56,100 ($11,477 Cdn.) per year. Pensions are adjusted semiannually by a wage index factor. Various supplemental allowances are provided.	EMPLOYEE'S OLD AGE PENSION INSURANCE (EOAPI). It is an earnings-related benefit, payable at age 60, by 1989 will cover all employees. The benefit is calculated as a percentage of covered earnings per year of service. In 1987, the maximum total monthly benefit for an employee with 40 years of service and a dependent wife was ¥184,568 ($1,953 Cdn.). The benefit is indexed using the Consumer Price Index.	The second component of the retirement pension is an earnings-related benefit based on the number and level of contributions. The maximum pension is equal to 1.25% multiplied by the number of covered tax years since April 6, 1978, up to a maximum of 20 best years, times the average of revalued pensionable earnings. The annual pension payable to an employee with an average wage and 40 years of service, at age 65 is approximately £3,746 ($8,108.22 Cdn.). Benefits are actuarially increased for deferred retirement.	The amount of a monthly benefit award is determined by first computing an insured worker's average monthly wage (AMW) or - in case of most workers who attain age 62, become disabled, or die after 1978 - average indexed monthly earnings (AIME). The AMW or AIME is then linked to the monthly benefit payable at age 65 - called the primary insurance amount (PIA). In 1987, the maximum monthly benefit payable to individuals at age 65 was $832.60 U.S. equivalent to $1046.20 Cdn.

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QUESTIONS (Cont.)	FRANCE	JAPAN	UNITED KINGDOM	UNITED STATES OF AMERICA
c) tested against post-retirement income?	The minimum social security pension of F13,230 ($2707 Cdn.) may be supplemented by a means-tested benefit from the National Solidarity Fund up to F17,800 ($3,642), resulting in a combined minimum old age pension of F31,030 ($6,349 Cdn.). Retirement pensions in pay are subject to adjustment January 1st and July 1st each year, on the basis of a factor fixed by the government and relating to the wage index.	The Earnings-related Old-Age Benefit payable at age 60 is subject to a retirement test, until the beneficiary reaches the age of 65, the scheme provides both a fixed-rate and earnings-related benefits.	The Social Security Act 1966 introduced a new system of state supplementary benefits, payable according to a means test. Persons over retirement age whose incomes, disregarding certain minimum, are eligible for supplementary benefits. In 1987, the benefits were: single £30.95 ($66.99 Cdn.); married £61.85 ($133.87 Cdn.). Additional supplements are payable to the blind, persons requiring special diets, and those over age 70 who require assistance with their heating bills.	Benefits are subject to an earnings or retirement test, under which part or all of benefit payments are withheld when earnings of a beneficiary under the age of 70 exceed amount specified in the law. Benefits are indexed annually using the Consumer Price Index. If there is no inflation, i.e. there is not a difference of at least 1/10th of 1%, then there is not indexation. No inflation, no indexation.
2. What are the contribution levels for each of the employee, the employer and the government? Are the current levels forecasted to stay the same or to increase?	Employee and employer contribution rates are in percentages of earnings that generally are subject to a ceiling. The ceiling is subject to change automatically twice a year each year on the basis of an earnings index. The current contribution rates and ceiling for benefits generally regarded as "social security" are: 6.4% for the employee and 8.2% for the employer, a total contribution rate and ceiling of 14.6%.	NATIONAL PENSION PROGRAM (NPP). The standard contribution rate is ¥7,400 per month ($78.30 Cdn.) from April 2, 1987; it is increased by ¥300 ($3.17 Cdn.) per year up to April 1990. Individuals may pay additional contributions of ¥400 ($4.23 Cdn.) per month to buy a supplemental benefit to the NPP. EMPLOYEE'S PENSION INSURANCE PROGRAM. In 1987. If fully covered under government-administered plan Employee: Male / Female — Employer: Male / Female (%) (%) (%) (%) 6.20 5.80 6.20 5.80 If partially contracted out 4.60 4.30 4.60 4.30	Contributions are required of all individuals receiving income in the United Kingdom. They are based on the weekly amount of employee's earnings and depend on whether a person is employed, self-employed or non-employed, ranging from a low of 5.00% to a high of 9.00% for the employee and a low of 5.00% to a high of 10.45% for the employer.	Monthly benefits are financed principally through contributions from employers, employees, and the self-employed. Scheduled contribution rates are as follow: YEAR — EMPLOYER AND EMPLOYEE, EACH — SELF-EMPLOYED 1986 — 7.15% — 14.3% 1988 — 7.51% — 15.02% 1990 — 7.65% — 15.3% 2000 — 7.65% — 15.3%

.../3

QUESTIONS (Cont.)	FRANCE	JAPAN	UNITED KINGDOM	UNITED STATES OF AMERICA
3. What are the covered earnings and how does this relate to an average industrial wage?	The maximum annual earnings subject to contributions in 1986 was F112,200 ($22,954 Cdn.) almost one and a half times the average wage. The basic benefit is 50% of base salary, which is the average pensionable earnings on which contributions were based for the best ten years prior to claiming the pension.	The earnings ceiling in 1987 was ¥5,640,000 ($59,119 Cdn.) almost 1.5 times the average annual wage. For an individual receiving the maximum old age pension, the replacement rate is almost 73% of maximum pensionable earnings.	The earnings ceiling is £15,340 ($31,121 Cdn.) almost two times the average wage. The retirement pension system provides a replacement rate of more than 40%.	In 1988 the annual maximum taxable earnings (covered earnings) were $45,000 U.S. ($56,250 Cdn.) almost 2.5 times the average annual wage $18,412 U.S. ($22,742 Cdn.). Basic retirement benefits are expected to replace a constant proportion of about 41% of prior covered earnings for persons who worked a full work-life with earnings equal to the average in the economy and retired at the full-benefit retirement age.
4. Does the plan permit contracting out, and if so, how is portability handled?	No	NATIONAL PENSION PLAN. Not provided. EMPLOYEE'S PENSION INSURANCE. Only the earnings-related part is contracted out. PORTABILITY. The basic Employee Pension Fund (EPF) pension must be preserved (locked in) when an employee terminates employment from an employer with a contracted-out plan. The vested pension rights are preserved by one or two methods: - If termination takes place after ten years of participation, the pension rights are guaranteed through a paid-up deferred pension within the foundation. Upon request of the EPF, a 15-year period may be substituted for the ten-year period.	Yes, the British System does provide contracting-out for the earnings-related component. Any employee covered under a contracted-out scheme who leaves the employer's service must have his accrued Guaranteed Minimum Pension (GMP) preserved and guaranteed, regardless of whether he meets the requirements of the occupational scheme for fully preserved benefits (generally two years of service). TERMINATION OF CONTRACTING-OUT. When a group of employees ceases to be contracted out (for reasons such as wind-up of the occupational scheme, merger or takeover of the employer's election), the employer may:	No

QUESTIONS (Cont.)	FRANCE	JAPAN	UNITED KINGDOM	UNITED STATES OF AMERICA
		- For all other cases of employee termination, the records and reserves necessary to pay the benefits are transferred to the Employees' Pension Fund Association, which is a clearing-house for all contracted-out plans. The Association pays benefits when the individual retires. Additional benefits usually are paid as lump-sum upon termination of employment. This is consistent with the philosophy that additional benefits are akin to severance pay. PLAN TERMINATION. On termination of an EPF plan, an amount sufficient to cover the actuarial liabilities for equivalent benefits must be transferred to the government, which takes full responsibility for these equivalent benefits. Any assets in excess of the equivalent amounts are distributed to plan members in a lump sum.	- Arrange for preservation of GMPs within a continuing scheme, as with individual terminations, or - Arrange for the state to assume the full obligation for GMPs. If the state scheme is to assume all liabilities for GMPs, Accrued Rights Premiums for active employees and Pensioners Rights Premiums for pensioners must be paid to the state scheme.	
5. Is the plan strictly pay-as-you-go, or is there an underlying fund? If the latter, how big is it currently, and how is it forecasted to grow? How is it invested?	The schemes are operated on a pay-as-you-go basis. Benefits payments are financed essentially from employer and employee contributions. There is only a limited reserve.	The accumulated reserve funds from employees' pension and national pension programs now stand at ¥53.3 trillion ($0.56 trillion Cdn.). These reserves are deposited with the Trust Fund Bureau of the Ministry of Finance and are credited with an interest rate of 6.05%. They are invested in public housing, hospitals, waste disposal facilities, and other public	The National Insurance benefits (pensions, Statutory Sick Pay, Statutory Maternity Pay, unemployment and work injury compensation) are financed through National Insurance Fund, supported by earnings-related contributions and from general revenues which in total is equal to about 20% of combined employee and employer contributions.	Social Security Insurance benefits are paid from general revenues, from taxes collected from employees, employers, and the self-employed. Social Security Taxes are deposited in three separate trust funds: The Federal Old-Age and Survivors Insurance Trust Fund; The Federal Disability Insurance Trust Fund, and The Federal Hospital Insurance Trust Fund. The money received by the trust funds can be used only to pay the benefits and operating expenses of the program. Money not needed currently for these purposes

.../5

QUESTIONS (Cont.)	FRANCE	JAPAN	UNITED KINGDOM	UNITED STATES OF AMERICA
		entreprises. One-third of new funds are loaned to employers and local governments to be used for the welfare of ensured persons.	Redundancy payments (involuntary lay-off insurance) are financed by earnings-related contributions. Occupational pension plans in the United Kingdom almost invariably are funded. Part or all of the State Earnings-Related Pension Scheme may be provided by an occupational or personal pension scheme if the employee has been in contracted-out employment. Both insurance and self-invested pension trust funds are used for the financing of pension obligations. The tendency is for the smaller plans to be insured, and the larger plans to be self-invested. In 1979 the market value of all private sector pension scheme assets were estimated at £36 billion ($77.92 billion Cdn.). Important exceptions are the pensions arrangements by those employed by the central government employed directly by the central government, notably the civil service, the armed forces, teachers, and the police (pay-as-you-go plans). A principal reason for the widespread use of funding is the favorable tax treatment extended to approved pension arrangements: contributions by employers and employees, as well as investment returns on pension assets, are exempt from all forms of taxation.	is invested in interest-bearing securities guaranteed by the U.S. Government. In 1985, the OASI and DI funds total assets were estimated at $42,000 million U.S. ($56,000 million Cdn.). Interfund borrowing among the Social Security trust funds is allowed to permit a fund with a deficit to borrow from a fund with a surplus, easing temporary cash-flow problems.

APPENDIX B

APPENDIX B

Briefing Note on The Financial Implications of Increasing the Replacement Rate of the Canada Pension Plan

The Proposal

The Canada Pension Plan currently provides a 25% replacement rate on insured earnings. Some interest has been expressed in a proposal to increase the replacement rate provided for by the CPP, thereby overcoming some of the shortcomings of the present retirement income system in Canada.

The CPP Advisory Board has asked that several options be looked at, all with a view to eventually increasing the CPP replacement rate to 50%. The key difference in the options is the speed with which the replacement rate goes from 25% to 50%. One option introduces the new level of benefits immediately, another option has a 10-year phase-in, a third option uses a 20-year phase-in, while the final option has a 30-year phase-in. The phase-ins are structured exactly like the CPP when it was first introduced in 1966. In the period from 1966 to 1975, new benefits coming into pay were subjected to an additional calculation which adjusted the benefits for the number of months less than 120 in the beneficiary's contributory period. In addition, the original 3.6% contribution rate has been simulated in order to see what the effects of the four phase-in speeds would be on the three critical years of the Plan. In all cases, it has been assumed that CPP II would begin operation in January 1990. No benefits actually becomes payable until 1991, but the contributions and hence credits for this new structure start in 1990.

This note details the estimated cost of introducing a new CPP, referred to here as CPP II. Effectively CPP II, which would by itself eventually provide a 25% replacement rate, would be added to the current CPP to arrive at the 50% replacement rate. The costs were prepared by the Office of the Superintendent of Financial Institutions (formerly the Department of Insurance).

The Findings

The four versions of CPP II which have been run will be presented according to the level of expense -- that is the most expensive first and the least expensive last. Incremental costs and PAYGO contribution rates for each option will be shown for a number of selected years.

A) CPP II with no Phase-in

This option would start paying benefits in 1991 with benefits being calculated as 25% of contributory earnings and no out of the ordinary allowance made for the short length of the "new" contributory period, which begins in January 1990. The costs would be significant, as the following table indicates. The option also raises certain equity considerations, which would be introduced as a result of the no phase-in approach.

YEAR	ADDITIONAL EXPENDITURE ($ Million)	PAYGO RATE (%)
1990	174	0.10
1991	331	0.18
1992	622	0.32
1993	919	0.44
1994	1,221	0.56
1995	1,529	0.66
2000	5,464	1.74
2005	12,100	2.87
2010	23,115	4.13
2020	69,304	7.32
2030	161,697	10.30
2040	287,446	10.63
2050	482,000	10.39

Run #19551

B) CPP II with a 10-Year Phase-in

This option follows the pattern established when the CPP was originally introduced in 1966. For the first 120 months, from the beginning of 1990 to the end of 1999, all of the benefits coming into pay under CPP II are adjusted for the fact that the beneficiary will not have made ten years worth of contributions and as a consequence not qualify for a "full" pension. In the long run, (i.e., for this configuration by about the year 2030) the costs associated with this option end up being identical to the costs associated with a CPP II with no phase-in.

YEAR	ADDITIONAL EXPENDITURE ($ Million)	PAYGO RATE (%)
1990	174	0.10
1991	228	0.12
1992	313	0.16
1993	404	0.19
1994	500	0.23
1995	603	0.26
2000	4,017	1.28
2005	10,670	2.53
2010	21,837	3.90
2020	68,514	7.24
2030	161,697	10.30
2040	287,446	10.63
2050	482,000	10.39

Run #19561

C) CPP II with a 20-Year Phase-in

The third option presented involves a more gradual introduction of the benefits under CPP II. The new benefits are phased-in over a twenty-year period. All new entitlements coming into pay during the transition period are subjected to an adjustment for the proportion of the required 240 month minimum contributory period for a "full" benefit. Once again, in the long run (i.e., in this case by about the year 2040), additional costs are the same as a CPP II with no phase-in.

YEAR	ADDITIONAL EXPENDITURE ($ Million)	PAYGO RATE (%)
1990	174	0.10
1991	219	0.12
1992	285	0.15
1993	358	0.17
1994	436	0.20
1995	519	0.22
2000	2,274	0.73
2005	7,693	1.83
2010	18,404	3.29
2020	65,869	6.96
2030	160,655	10.23
2040	287,447	10.63
2050	482,000	10.39

Run #19571

D) CPP II with a 40-Year Phase-in

The fourth option effectively has no acceleration period. It takes a full 40 years of contributions to earn a "full" retirement benefit. Contributors reaching age 65 in 1991 are entitled to 2.5% of a normal retirement pension. This percentage is increased by 2.5% for those reaching age 65 in each of the subsequent years until it equals 100% for those reaching age 65 in 2030 and later years.

YEAR	ADDITIONAL EXPENDITURE ($ Million)	PAYGO RATE (%)
1990	174	0.10
1991	209	0.11
1992	256	0.13
1993	308	0.15
1994	366	0.17
1995	430	0.18
2000	1,471	0.47
2005	4,124	0.98
2010	9,940	1.78
2020	43,090	4.55
2030	131,831	8.40
2040	267,861	9.91
2050	474,713	10.23

Run #19572

Critical Year Analysis

The cost estimates prepared included a simulation of what the effect of the new CPP II would be on the so-called critical years. When the CPP was originally introduced, analysts talked about the critical years of the Plan when key funding developments occurred. The first critical year occurred when the cash flow to the provinces turned negative. With a constant 3.6% contribution rate, the CPP in its early years built up a considerable Fund which resulted in monies not immediately needed for benefits expenditures being available to be loaned out to the provinces. The interest payable on these loans in the first 20 years of the Plan was less than the amount available to be loaned. However, in 1985, the amount of interest owing to the Plan exceeded the amount available to be loaned - hence the term a negative cash flow. The second critical year would occur when the requirements for benefit expenditures matched the total of contributions and interest income in a particular year. The third and final critical year would occur when the benefit expenditure requirements matched all the contributions, all the interest and whatever is left in the Fund. Effectively, this critical year is the year when the Fund becomes depleted.

The following brief table shows what would happen to the three critical years if the four versions of CPP II all started out with a constant 3.6% contribution rate in 1990.

CPP II

		Phase-in Period		
	Immediate	10 Year	20 Year	40 Year
Critical Year #1	2009	2009	2011	2018
Critical Year #2	2016	2017	2019	2027
Critical Year #3	2025	2027	2030	2040

The Combined Effect of CPP and CPP II

The introduction of a plan like CPP II would mean that contributors would continue to pay their regular CPP contributions and in addition pay an extra premium to help finance CPP II. The funding scenario for CPP II has not yet been formulated, so the following presentation shows the combined contribution rate assuming a PAYGO Funding philosophy for both CPP's. Of course, the regular CPP has just recently established a 25-year financing schedule with a long range objective of having a fund roughly equal to two years worth of benefits. Nonetheless, for purposes of illustration, assume both CPP and CPP II operate as PAYGO plans.

Combined PAYGO Contribution Rates
Existing CPP Plus CPP II
Phase-in Period

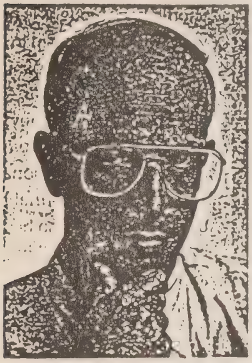
Year	Existing CPP (%)	Immediate (%)	10 Year (%)	20 Year (%)	40 Year (%)
1990	5.63	5.73	5.73	5.73	5.73
1991	5.74	5.92	5.86	5.86	5.85
1992	5.85	6.17	6.02	6.00	5.99
1993	5.94	6.38	6.13	6.11	6.09
1994	6.06	6.62	6.29	6.26	6.23
1995	6.18	6.84	6.44	6.41	6.37
2000	6.75	8.49	8.03	7.47	7.22
2005	7.19	10.06	9.72	9.01	8.16
2010	7.88	12.01	11.78	11.17	9.66
2020	10.09	17.41	17.32	17.04	14.64
2030	12.03	22.33	22.33	22.27	20.43
2040	11.81	22.44	22.44	22.44	21.71
2050	11.49	21.88	21.88	21.88	21.73

Data Development and Analysis
Income Security Programs Branch
April 20, 1988

APPENDIX C

CONGRESS IOULD KEEP ITS HANDS OFF THIS NEST EGG

BY ALAN S. BLINDER



The Social Security fund will soon accumulate ·normous surpluses. .iandled wisely, they offer an historic ›pportunity to transform the U.S. into a low-interest-rate, high-investment society

3LINDER IS THE GORDON S. RENTSCHLER MEMORIAL PROFESSOR OF ECONOMICS AT PRINCETON AND AUTHOR OF *HARD HEADS, SOFT HEARTS*

The secret is out. Something that students of the Social Security system have known since 1984 is now creeping into the public consciousness and into the minds of politicians: The Social Security trust fund is generating surpluses that will accumulate to huge amounts in the first quarter of the 21st century before declining in the next quarter-century. After that the system may well run out of money.

The Social Security bulge was created when Congress adopted the Greenspan Commission's recommendation to transform Social Security from roughly pay-as-you-go to a more or less funded system in 1983. Under the former approach, each year's payroll tax receipts roughly covered that year's benefits. The trust fund picked up any surplus or made good any deficit. But the fund itself was mostly an accounting fiction; the balance typically amounted to less than one year's outlays. The funded plan we now have works quite differently. The Social Security trust fund is scheduled to accumulate trillions of dollars and subsequently spend them on benefits.

Why change? After all, pay-as-you-go worked beautifully for generations of Americans, almost all of whom received more in benefits than they had contributed in taxes. The answer: Demography dictated the change. Because birth rates were so high during the postwar baby boom and have been so low recently, the retired population will grow much faster than the working population after about 2010. Pay-as-you-go financing would then require either sharply higher payroll taxes or sharply lower benefits. The Greenspan Commission wisely recommended that the system accumulate a huge fund while the baby boomers work, and then draw it down.

TOUGH CALL. How large the trust fund will grow is impossible to say, for it depends on the evolution of such things as fertility, real wages, and real interest rates. Predicting these variables 50 or 60 years ahead is hazardous, to say the least. Under the "moderately pessimistic" assumptions of the Social Security actuaries, the trust fund, which is now less than $100 billion, eventually will surpass the astounding sum of $12 trillion and then shrink rapidly. In more meaningful terms, it will rise from about 2% of gross national product now to almost 30% of GNP around the year 2020 and then fall, hitting zero before 2050 and continuing into the red.

Whatever the true magnitudes, the unprecedented rise and fall of the Social Security trust fund presents both opportunities and perils. For example, the current version of Gramm-Rudman dubs Social Security "off budget" but nonetheless counts both its income and outlays in assessing compliance with the law's deficit-reduction targets. Hence the rising Social Security surplus will make it much easier to meet the Gramm-Rudman targets between now and 1993. The Congressional Budget Office estimates that the annual Social Security surplus will be about 1.5% of GNP in fiscal year 1993. That means the balanced-budget target for that year translates into a deficit in the non-Social Security budget of 1.5% of GNP—which is well within historical norms and certainly attainable.

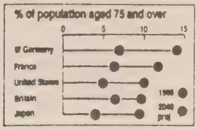
But the biggest problems and opportunities come later, when the battle over the disposition of the Social Security bulge will be fought. The danger is clear. With chronic surpluses in future government budgets and untold trillions sitting in the Social Security kitty, legislators surely will be tempted to spend some of the largesse on worthy causes. This we must resist, for if we fail to squirrel the money away, we will not have the wherewithal to pay the retirement bills when they come due. Congress must realize that the multitrillion-dollar nest egg that will be incubating in the Social Security trust fund is not spare money; it is spoken for. Indeed, it may not be enough.

On the other hand, if we manage to save the coming Social Security surpluses, we have a historic opportunity to transform the U.S. into a low-interest-rate, high-investment society unlike any we have seen in years. According to the actuaries' "moderately pessimistic" projections, assets in the trust fund when it peaks (as a share of GNP) around 2020 may come close to the entire national debt. If the fund continues to invest solely in Treasury securities, it may therefore be able to eliminate the public debt. That in itself would give interest rates a mighty shove downward and investment a corresponding shove upward.

WELL-FOUNDED FEARS. But there is even more potentially good news—and an even greater peril. Some fear that persistent, large federal budget surpluses will be a drain on economic activity. If we bungle the job, such fears will be well-founded.

The stakes are high. To win the battle over the Social Security bulge, we need enlightened fiscal and monetary management, which history shows to be elusive. However, one small accounting change might help. If we take Social Security truly off the budget when Gramm-Rudman II expires in 1993 and focus congressional attention on the non-Social Security budget, future politicians may be less tempted to spend what they do not have.

Paying for granny



The soaring costs of tomorrow's pensions—and how to hold them down

THE social-affairs ministers of the OECD have just spent a glum couple of days in Paris. They have been contemplating the time when one person in five will be a pensioner, and one in ten over 75; when only three people of working age will have to earn the wealth to support each pensioner; when old-age pensions will account for one-fifth of national income. This geriatric nightmare is what the OECD predicts for the average industrial country in the year 2040. And the average is improved by such relatively youthful countries as the United States, Australia and Turkey. In aging Switzerland and doddering West Germany, there will be one old person for every two adults of working age.

By the year 2040 the social-affairs ministers will be long gone. But they are right to start thinking about it now. For many countries have a brief respite in the 1990s, as the smaller generation born during and after the first world war retires. Early in the next century the numbers of old people will start rising again. At the same time, the decline in the number of babies born in the 1970s and early 1980s will lead to a smaller number of workers. If birth rates do not recover significantly, a generation of increasingly elderly workers will have to earn the money to finance the pensions and health care required by their grandparents. The median age of the American population today is 32; by the year 2030 it will be about 41—a rise of nine years in four decades. Yet America, rejuvenated by immigration, will seem youthful. Japan, transformed more abruptly by falling births and rising life expectancy, is becoming the oldest nation in the world. How then, its leaders fret, will it compete with Taiwan and South Korea?

For the social-affairs ministers, the main question is how to cope with the consequences for taxes and public spending of this demographic revolution. Given today's state pensions, only four OECD countries expect to spend less than 10% of national income on pensions by the year 2020: Australia, Britain, and youthful Ireland and Turkey. Open-handed Italy will be spending over a quarter, with worse to come. Add to such numbers the extra burden of caring for the oldest old: Britain's health service spends ten times as much on the care of a patient over 75 as on one of working age.

Not just a burden

Terrifying though the prospect of granny power sounds, a bit of constructive thinking can make it more manageable. The elderly of tomorrow will not be the same as the elderly of today. Many of them will be richer, better educated and healthier than their parents and grandparents. Governments need to turn these qualities to their advantage.

Most state pension schemes were designed when being old was equated with needing state help. Now, some of the old are richer than their children. In Australia, Canada, Norway and Sweden, poverty is rarer among the old than among the population at large. In America, on some measures, the typical old person is better off than the typical worker. Many more old people own their homes, and have a pension from their job as well as from the state. Some of these new occupational pensioners are women: in 1972 only 31% of British women over 55 years old and in a full-time job belonged to their employer's pension scheme; by 1983, 63% did. It makes no sense to promise rich pensioners the same state benefits as poor. Wise governments will target help on the poorest old: such as the long-term unemployed, who never contributed much to any scheme, and lone parents, who spent years in unpensioned part-time jobs.

If the state pays less to wealthier old folk, a problem remains. Somebody will still have to earn the output to pay the return on their private assets. You cannot, as it were, feed tomorrow's children with bread baked today. Possible solution: persuade more of the elderly to keep working. Because many more old people are in their active 60s than their frail 80s, it will take only a small rise in the average retirement age to make a big difference to the arithmetic of dependency. Retirement is a newish idea: two generations ago, most old people assumed they would work till they dropped. Those in interesting jobs still do. Sir Fred Pontin, at the age of 81, has just become chairman of a booming London restaurant chain. Of the 24 heads of OECD governments, ten are over 60. Lots of other old people do unpaid work. One British study found that 43% of over-65s regularly helped other elderly people; 25% helped the disabled; 11% helped neighbours.

In the next century there may be many more Fred Pontins. Those who retire today grew up in the deprived 1920s and 1930s. Those who reach old age in 2040 will not only have had better health care in their childhood than granny ever did; they will have shunned smoking, spirits and cream cakes, and jogged for two hours a week. This virtuous generation may stay healthier for longer than today's old.

Even today's elderly may be capable of more than society expects of them. Workers in their 60s and 70s can often outperform those in their 20s (though not those at their peak in their 30s and early 40s), as long as they are doing a job they are used to. Experience and motivation compensate for loss of speed. The old may take longer to retrain, though not necessarily: *The Economist*'s sexagenarian deputy editor has mastered telecommuting with more zeal than his younger colleagues. But to keep the old in work will mean other changes: in pay structures and pension schemes, which can unacceptably raise the cost of hiring the old, or in tax rules, which can discourage part-timers.

One task that may fall increasingly to the young elderly is that of caring for their own parents. Those who are now in their late 80s belong to the Vera Brittain generation: many lost husbands or fiancés and had no children. But one British study suggests that 84% of those who reach the age of 60 in the early 1990s will have at least one child alive when they die.

To encourage more of those children to care for their parents, governments could offer granny a deal: rely on your family for help, and you can bequeath your house almost tax-free; leave the job to us, and we will recoup the cost from your estate.

The age of the granny will bring opportunities as well as problems. Some poor countries will suddenly find the advantages of being hot and cheap. They will emulate Spain and Florida, which already do a flourishing business in caring for aging refugees from northern chills. Lots of new low-skill service jobs will appear in today's OECD countries: gardeners, delivery boys, helpers. Some of them may be done, part-time, by the fairly old. And an aging society may be freer from crime and drugs than the 1980s have been. That should cheer the social-affairs ministers up a bit.

Report of the Canada Pension Plan Advisory Board on the Level and Structure of CPP Retirement Benefits: A Dissent

Louis Erlichman

I disagree with the conclusions of the majority of the Advisory Board. I believe that there is a pressing need for an increase in the level of retirement benefits provided by the Canada Pension Plan, based both on existing inadequacy and the impact of future labour market changes.

I believe that it is a public responsibility in an advanced industrial nation to ensure that all retirees have incomes above the poverty level, and to ensure income maintenance for low- and middle-income earners. Increased CPP retirement benefits are essential to bring about this result.

The majority report provides a clear evidence of the inadequacy of our existing pension system in meeting these goals. The current CPP, in conjunction with the Old Age Security and Guaranteed Income Supplement, does not guarantee either an income above the poverty level or an adequate level of income replacement. The private pension system does not and cannot make up the shortfall.

I will try to elaborate on the reasons for my dissent by commenting on the majority report.

The majority report compares federal public pension benefits in Canada to those of a select group of other countries. Canadian benefits are at the bottom end of the comparison scale, for both the proportion of average earnings covered and the maximum benefits achievable in relation to coverage. I believe that further investigation would show that Canada trails not only the four countries surveyed for this Report, but most of the rest of the western industrialized world, in the level of coverage provided by its public pension system, even though our relatively young population would make equivalent coverage relatively inexpensive.

It should also be noted that we pay substantially less for our public pension benefits than citizens of the other countries surveyed, an indication that improved benefits will not create a competitiveness problem.

I am in general agreement with the Report's Section IV, which outlines the clear advantages of the CPP over private pension arrangements, though I believe that the 75% figure quoted for private coverage is inflated and does not present a true picture of either the quantity or quality of private pension coverage.

It seems to have been arrived at by excluding low paid workers (below 75% of the average wage) who have very much lower levels of "coverage" and including as covered anyone who had any level of contribution made to a registered pension plan or RRSP in a given year, whether or not such contributions would generate significant retirement income.

In fact, only 36.7% of the labour force belonged to registered pension plans in 1986, and many of these plan "members" would not be accumulating a significant retirement benefit during the year. The addition of RRSP contribution figures raises total coverage rates only marginally. For wage earners, on the other hand, CPP coverage is virtually universal.

Unfortunately, the majority report's recognition of the inherent superiority of the CPP is not reflected in the Report's recommendations, which still exhibit unrealistic expectations about the private system's capacity to overcome shortcomings in coverage.

I cannot accept that older Canadians should be denied an adequate income only so that the private pension industry can have the tax subsidized scope to maintain its profits and financial influence.

Canada's social security system, including the CPP, has two complementary roles -- alleviating poverty among the elderly and providing income maintenance in retirement for low- and middle-income earners. Over the last few decades this system has made substantial strides towards guaranteeing a decent standard of living for all of Canada's elderly.

Unfortunately, instead of continuing to move forward, the public pension system in this country is now facing attempts to roll it back. The recent proposals to tax back OAS benefits from "high income earners" would lead within 20 years to a taxback from those earning around $27,000 a year in 1989 dollars -- the average industrial wage.

This sneak attack is not aimed at phantom "bank presidents" but at middle-income Canadians. It indicates a desire to restrict the role of public pension benefits to income supplementation, at or below the poverty line, in spite of the unquestionably superior efficiency and effectiveness of the public system.

The majority Report's section on "Fiscal Impact" is somewhat confusing. There has been no demonstrable effect on savings rates as the result of either the current or enhanced CPP benefits, and the economic impact of an investment fund would depend more on the nature of investment policy than the size of the fund. I would argue that, in the context of the long run aging of the population, it will be economically essential to maintain the purchasing power of the elderly if our economy is to prosper in the coming decades.

The majority Report suggests that, because CPP is funded through a payroll tax, while Old Age Security and Guaranteed Income Supplements are funded out of more progressive general taxation (an increasingly questionable presumption), an increase in benefits to low- and middle-income earners would be regressive, and would particularly hurt people who would pay more in CPP contributions and have a large part of increased CPP benefits offset by reduced GIS benefits.

Since GIS is "taxed back" at a 50% rate, it is true that low- and middle-income earners might only end up with benefits increased by half the increase in CPP benefits. I do not find this an unhappy result. Replacing the GIS (which was intended as a limited "safety net" to progressively disappear as CPP coverage and benefits improved) with a higher level of income maintenance with entitlements paid for through CPP contributions is a positive result. Our increasingly regressive tax system should be dealt with head-on, not as an excuse not to expand public pension benefits.

If the majority is concerned with "wasted" contributions, perhaps they might propose an end to all private pension coverage for all low- and middle-income earners, since it also results in the dread taxback effect.

Given the current Government's clear intent to end "universality" in public programmes, a growing role for the CPP, based on earned entitlement through contributions may be the best guarantee that low- and middle-income earners will not become disentitled in the future.

The majority report ignores the crucial role the CPP plays in combatting poverty among the elderly, a role which will grow if the attack on the universality of the OAS continues. Currently, a single person receiving Old Age Security and the full GIS receives $3000 less than the 1989 National Council of Welfare annual low-income cutoff for large cities. Receiving the maximum CPP payable at age 65 plus the GIS raises the retiree barely to the low-income cutoff level.

Most retirees are not, however, eligible for the maximum CPP benefit. Someone in receipt of the average CPP retirement benefit at age 65 in 1988 ($378 a month) plus the OAS and GIS still falls $2000 below the low-income cutoff.

This important argument for an improvement in public benefits simply to raise the elderly above the poverty level is totally neglected in the majority report.

The majority report exaggerates the importance and potential of the private pension system in providing for the income needs of the elderly. According to Statistics Canada, in 1986 private pensions provided only 15.7% of the income of those over 65.

The majority report suggests that the "pension reform" of the last few years will lead to a substantial increase in retirement income to Canada's elderly. My own belief is that this pension reform, while making the operation of the private pension system more equitable, will not lead to any significant increase in the provision of retirement income to Canadians. In fact, because of the increased complexity of administration required, it is more likely to reduce the coverage of Registered Pension Plans provided by small employers.

The core of the majority report's justification for a CPP benefit standstill is found in Sections VI and VII. Unfortunately, the data to support this justification is set out rather confusingly in exhibits 1-4.

First, to comment on the "criteria" laid out in Section VI: It certainly makes sense to accept the single individual earner as the model of income adequacy calculations. The single-earner couple is increasingly an anomaly and with credit-splitting, conceptually difficult to deal with.

In the light of what I said earlier on the importance of CPP in attacking poverty, and the importance of reducing the scope of the GIS, I feel that the summary dismissal of the needs of low-income earners is unacceptable.

In assessing the adequacy of coverage, it is only reasonable to focus on the level of publicly-provided universally-available benefits.

The majority report overstates the importance of other sources of retirement income. I have already discussed the limits of the private pension system. The inclusion of an unspecified national value for home-ownership in the estimation of retirement incomes is unreasonable. There is little that changes either for owners or renters at retirement. Home-ownership is unevenly distributed and there is little evidence that long-run shelter costs for elderly owners are significantly lower than for renters.

There is an implication in the majority report that most Canadians approach retirement in a state of considerable financial comfort, having accumulated substantial financial assets, and saving a high proportion of their income, which is at the highest level of their lives.

This portrait is patently untrue. According to Statistics Canada, the average elderly household has assets only slightly greater than those of younger households. Even if some of the elderly do own some consumer durables, it is ridiculous to talk of people entering 15-20 years or more of retirement being able to live off their paid-off cars, appliances and unindexed pensions.

If it is in fact true that incomes are highest just before retirement, then the CPP replacement rates in exhibits 2, 3 and 4 are too high, since they are apparently based on benefits calculated as if final earnings were lifetime earnings.

Another factor not considered in the majority report is the trend in the labour market towards a more mobile workforce, a trend which will be encouraged by the recent U.S./Canada trade deal. Higher turnover, more part-time work, more time spent unemployed, retraining or in low-paid temporary jobs will lower CPP benefits for many future workers.

The increase in the share of employment in service sectors with low private pension coverage and the increased female participation rates, also connected to lower private pension coverage, can also be expected to lower the coverage and effective income replacement rates of our private pension system.

Most workers already do not receive the maximum CPP retirement benefit. In March 1989, the average new benefit was $306 per month (only 55% of the maximum). Even the average new benefit taken at age 65 was only $378 (68% of the maximum), so income replacement calculations based on maximum CPP retirement benefits are unrealistic.

In any case, the core of the argument for improved CPP retirement benefits is found in exhibit 2, column (3). The replacement rates for OAS and CPP on an after-tax basis range from 64% to 30% for people with gross earnings of $10,000-$40,000 annually in 1984. This, together with the need to alleviate poverty, is the reason why CPP retirement benefits need to be increased.

Finally, I would like to comment on exhibit 4, which is likely to be quoted as proof of the adequacy of the current situation and which is, in my opinion, rubbish. First, everything (including the kitchen sink -- home-ownership) is assumed to be post-retirement income, on a valuation basis which is unclear. The tax gains resulting from being over 65 are included before calculating a replacement rate. Low-income earners are totally excluded. The data is based on one-earner households, which the majority report previously argued is unacceptable. I cannot understand why this totally misleading exhibit is included in the report.

To conclude, I would reiterate my disappointment at the failure of the majority report to take this opportunity to bring back onto the public policy agenda the need for a much needed improvement of our public pension benefits.

CPP Advisory Board
Committee on the Level and
Structure of CPP Retirement Benefits

Minority Report

Geraldine Gilliss

When the Canada Pension Plan was instituted in 1966 it was acknowledged that it would not provide full protection for participants. However, assurances were given that the balance required for adequate retirement income would be provided through plans established voluntarily in the private sector and/or individual initiatives employing the RRSP vehicle. These assurances have been repeated whenever the question of increasing CPP retirement benefits has been re-examined. For example, the Parliamentary Task Force in 1983 reported that "Representatives of the business community assured us that it is feasible to deal with these problems, and to achieve substantial extensions in coverage, through voluntary measures".

Although there is persistent optimism about voluntary measures, experience does not appear to support it. Statistics prepared for the committee indicate (1) that at any one time approximately one quarter of middle earners do not participate in any pension arrangements (either registered pension plans or RRSP's) other than CPP and (2) that the rate of participation is not increasing. Moreover, it is not clear that those who participate in plans at any one point in time are protecting themselves adequately or will retain coverage over their working careers.

Since it seems that voluntary coverage is unlikely to materialize, the plain public policy issue is whether to insist that compulsory coverage be increased. It is true that some people do not like the idea of compulsion. However, it is also true that many young people do not appreciate the need for retirement income, are unwilling to set aside savings from their current income, and can only be protected against their folly through a compulsory system. Moreover, those who chance to be employed by concerns with pension plans do enjoy compulsory coverage with little complaint. If compulsory coverage is not soon adopted as public policy, yet another generation will be condemned to a much reduced standard of living in their retirement years.

Given that an extension of compulsory coverage is required to solve the most persistent pension problem in Canada, two choices for attaining that objective are open -- an increase in CPP benefits or mandatory establishment of private sector plans.

That choice is easily made, since CPP already has characteristics which have not been fully achieved in the private sector, despite earnest attention to pension reform. CPP is already universal, portable and fully indexed.

It is undeniable that extra costs for employees and employers would be involved in expanding CPP. However, the same results would flow from a similar expansion of the private sector. One approach which might reduce opposition to the necessary premium increases would be to phase in benefit improvements over a period of time. For example, a target benefit of 40% of the YMPE could be reached through a timetable including 5-point increases every 5 years. Under this plan, participants could begin to qualify for a 30% benefit in 1990, a 35% benefit in 1995 and a 40% benefit in 2005. A scale of premium increases attributable to the benefit increases could be developed and integrated with the existing scale of increases.

A review system could also be instituted to consider, prior to each benefit increase, whether coverage under private sector plans has in fact improved sufficiently that the next increase would not be necessary. This procedure would be consistent with the majority opinion of the 1983 Parliamentary Task Force, which was that, if there were not "sufficient improvement to the private sector within three years, the question of mandatory expansion of pension arrangements, either public or private, be formally referred to a parliamentary committee".

In this connection it would be useful to have sets of statistics prepared on an annual basis which would assist members of the Advisory Board and of Parliament to evaluate how well the public and private systems are doing in helping individuals achieve the goal of adequate retirement income. These statistics should consider only OAS, CPP, and pensions and annuities from private plans. Neither GIS nor

home-ownership should be considered, GIS because it is a means-tested benefit designed to fill in where earnings-related benefits are not available, and home-ownership because it is not clear that the benefit of owning a home in retirement substantially outweighs the cost of property tax and maintenance.

Contrary to the majority opinion of the Board it is the view of this Board member that government has a duty to the Canadian public to ensure that sufficient compulsory coverage is in effect to make certain that the average Canadian may retire in dignity and without any substantial reduction in standard of living.

May 24, 1989

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